

Part III. Administrative, Procedural, and Miscellaneous

Distributions to Private Foundations From Trusts or Estates: Net Investment Income

Notice 2004-35

PURPOSE

This notice announces that the Internal Revenue Service intends to propose regulations modifying the regulations under section 4940 of the Internal Revenue Code of 1986, as amended, with respect to distributions received by private foundations from trusts and estates.

BACKGROUND

Section 4940 imposes a tax on private foundations based on the foundation's net investment income. Net investment income is defined in section 4940(c)(1) as the amount by which the sum of the gross investment income and the capital gain net income exceeds certain deductions. Net investment income is to be determined under the principles of subtitle A except to the extent inconsistent with the principles of section 4940.

Treas. Reg. § 53.4940-1(d)(2) states that a distribution from a trust described in section 4947(a)(1) or (2) or from an estate does not retain its character in the hands of the distributee private foundation. Thus, these distributions are not included in net investment income for purposes of section 4940. Treas. Reg. § 53.4940-1(d)(2) also states that a distribution from a section 4947(a)(2) trust that is attributable to transfers in trust after May 26, 1969, retains its character in the hands of the distributee private foundation unless the income is taken into account as a result of the application of section 671. The regulation is silent on the treatment of distributions from trusts other than trusts described in section 4947.

Because distributions of income received by a private foundation from some types of trusts, but not other types of trusts or estates, are included in the private foundation's net investment income for purposes of section 4940, Treas. Reg. § 53.4940-1(d)(2) leads to inconsistent results. For example, a distribution of

income made during the administration of an estate for which a deduction is claimed under section 642(c) does not retain its character in the hands of the distributee private foundation. However, a distribution of income from a non-grantor charitable lead trust described in section 4947(a)(2) for which the trust claims a section 642(c) deduction does retain its character in the hands of the distributee private foundation, if the income is attributable to amounts placed in trust after May 26, 1969.

After studying the application of section 4940 and Treas. Reg. § 53.4940-1(d)(2) to distributions from various types of trusts and estates, the Treasury Department and the Internal Revenue Service have concluded that the disparate treatment of distributions under section 4940 is no longer appropriate.

PROPOSED ACTION

The Treasury Department and the Internal Revenue Service intend to propose regulations modifying Treas. Reg. § 53.4940-1(d)(2) to provide that a private foundation's net investment income for purposes of section 4940 does not include distributions from trusts and estates. Until further guidance is promulgated, income distributions from trusts and estates will not retain their character in the hands of a distributee private foundation for purposes of determining the foundation's net investment income under section 4940(c).

CURRENT RETURN PROCESSING

For current tax returns, any private foundation to which this notice applies should mark, "Filed pursuant to Notice 2004-35" on the front page of its Form 990-PF, *Return of Private Foundation or Section 4947(a)(1) Nonexempt Charitable Trust Treated as a Private Foundation*. Returns should be completed in accordance with this notice pending corresponding changes to Form 990-PF and the accompanying instructions.

REFUND PROCESSING

For years in which the statute of limitations has not expired and for which a refund of section 4940 taxes paid is

sought, the private foundation must file an amended Form 990-PF. The private foundation should mark the front page of the amended return (or returns) "Filed pursuant to Notice 2004-35."

COMMENTS

The Service welcomes comments and suggestions relating to the amendment of the regulations on distributions from trusts and estates to private foundations. Written comments should be submitted by August 9, 2004, to CC:PA:LPD:RU (Notice 2004-35), Room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, D.C. 20044. Comments may be hand delivered between the hours of 8 a.m. and 5 p.m., Monday through Friday to CC:PA:LPD:RU (Notice 2004-35), Courier's Desk, Internal Revenue Service, 1111 Constitution Ave., NW, Washington D.C. Alternatively, comments may be submitted electronically via e-mail to the following address: Notice.Comments@irs.counsel.treas.gov. All comments will be available for public inspection.

DRAFTING INFORMATION

The principal author of this notice is Ronald B. Weinstock of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this notice, contact Mr. Weinstock at (202) 622-3094 or contact Oksana O. Xenos of the Office of the Commissioner (Tax Exempt and Government Entities) at 202-283-9469 (not a toll-free number).

Split-Interest Trust Distributions to Private Foundations: Distributable Amount

Notice 2004-36

PURPOSE

This notice provides guidance to private foundations on the treatment of certain distributions received from split-interest trusts described in section 4947(a)(2)

of the Internal Revenue Code of 1986, as amended, in light of the courts' decisions in *Ann Jackson Family Foundation v. Commissioner*, 97 T.C. 534 (1991), *aff'd*, 15 F.3d 917 (9th Cir. 1994).

BACKGROUND

Section 4942(a) imposes a tax on the amount of undistributed income of a private foundation for any taxable year that is not distributed by the first day of the second taxable year following such taxable year. Section 4942(c) defines undistributed income as the amount by which the distributable amount for the taxable year exceeds the qualifying distributions made out of the distributable amount. Section 4942(d) defines distributable amount as the minimum investment return (plus certain refunds of amounts previously taken into account as qualifying distributions), reduced by the taxes imposed on the private foundation under subtitle A and section 4940. Treas. Reg. § 53.4942(a)-2(b)(2), provides that the distributable amount of a private foundation shall be increased by the income portion of distributions from trusts described in section 4947(a)(2) with respect to amounts placed into trust after March 26, 1969. In *Ann Jackson Family Foundation*, the Tax Court held that Treas. Reg. § 53.4942(a)-2(b)(2) was invalid to the extent the regulation requires including in the private foundation's distributable amount for the year the full amount of the income portion of distributions from split-interest trusts. The court determined that the language of section 4942 did not support this interpretative regulation.

PROPOSED ACTION

The Treasury Department and the Internal Revenue Service intend to propose regulations modifying the regulations under section 4942 in a manner consistent with the holdings of the Tax Court and the Ninth Circuit in *Ann Jackson Family Foundation*. Until further guidance is promulgated, private foundations should compute the distributable amount under section 4942(d) without regard to Treas. Reg. § 53.4942(a)-2(b)(2).

CURRENT RETURN PROCESSING

For current tax returns, any private foundation to which this notice applies should mark "Filed pursuant to Notice 2004-36" on the front page of its Form 990-PF, *Return of Private Foundation or Section 4947(a)(1) Nonexempt Charitable Trust Treated as a Private Foundation*. If a Form 4720, *Return of Certain Excise Taxes on Charities and Other Persons Under Chapters 41 and 42 of the Internal Revenue Code*, is filed, Schedule B (Initial Tax on Undistributed Income) should be computed disregarding distributions received from section 4947(a)(2) trusts. Returns should be completed in accordance with this notice pending corresponding changes to Form 990-PF and Form 4720 and the accompanying instructions.

Form 990-PF requires information with respect to not only the current tax year, but also prior tax years, particularly Parts XI and XIII. Private foundations may wish to complete these Parts as if prior year returns had been completed in accordance with this Notice rather than the Form instructions. Private foundations may include a schedule to show how the information provided on such return varies from prior year returns as filed. It is not necessary for a private foundation to file amended returns for prior years, but it will be expected to retain the supporting information and computations for the changes that would have been reflected had amended returns been filed.

REFUND PROCESSING

For years in which the statute of limitations has not expired and for which a refund of section 4942 taxes paid is sought, the private foundation must file an amended Form 990-PF and an amended Form 4720 for that year with a schedule showing the corrected amount of section 4942 liability pursuant to this Notice. The private foundation should mark the front page of the amended return (or returns) "Filed pursuant to Notice 2004-36."

COMMENTS

The Service welcomes comments and suggestions relating to the amendment of the regulations on distributions from split-interest trusts to private foundations. Written comments should be submitted by August 9, 2004, to CC:PA:LPD:RU

(Notice 2004-36), Room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, D.C. 20044. Comments may be hand delivered between the hours of 8 a.m. and 5 p.m., Monday through Friday to CC:PA:LPD:RU (Notice 2004-36), Courier's Desk, Internal Revenue Service, 1111 Constitution Ave., NW, Washington D.C. Alternatively, comments may be submitted electronically via e-mail to the following address: Notice.Comments@irs.counsel.treas.gov. All comments will be available for public inspection.

DRAFTING INFORMATION:

The principal author of this notice is Ronald B. Weinstock of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this notice, contact Mr. Weinstock at (202) 622-3094 or contact Oksana O. Xenos of the Office of the Commissioner (Tax Exempt and Government Entities) at 202-283-9469 (not a toll-free number).

26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.
(Also, Part I, Sections 692, 7508A; 1.692-1, 1.7508A-1.)

Rev. Proc. 2004-26

SECTION 1. PURPOSE

This revenue procedure provides guidance for representatives of certain military or civilian employees of the United States who die as a result of injuries incurred in a terrorist or military action. It provides guidance for having tax forgiven or for claiming refunds of tax under section 692(c) of the Internal Revenue Code, as amended by the Victims of Terrorism Tax Relief Act of 2001, Pub. L. No. 107-134. It also provides procedures by which the Secretary will determine whether a terrorist or military action has occurred.

SECTION 2. BACKGROUND

.01 Prior to amendment by the Victims of Terrorism Tax Relief Act of 2001, Pub. L. No. 107-134 (the Act), section 692(c)(1) provided that, in the case of any